

**STATE OF WASHINGTON
OFFICE OF THE INSURANCE
COMMISSIONER**



FINANCIAL EXAMINATION

**STATES WEST LIFE INSURANCE COMPANY
MOUNTLAKE TERRACE, WASHINGTON**

**NAIC CODE #94188
DECEMBER 31, 2002**

**Participating States:
Washington**

**Order No. G05-02
Exhibit A**

CHIEF EXAMINER AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of the STATES WEST LIFE INSURANCE COMPANY of Mountlake Terrace, Washington. This report shows the financial condition and related corporate matters as of December 31, 2002.



Patrick H. McNaughton
Chief Examiner

2-16-05
Date

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SALUTATION

Seattle, Washington
February 16, 2005

The Honorable Kevin McCarty
Chair, NAIC Financial Condition (E) Committee
Director of Insurance Regulation
Florida Dept. of Financial Services
The Larsen Bldg., 200 E. Gaines St., Room 101
Tallahassee, FL 32399-0301

The Honorable John Morrison, Commissioner
Montana Department of Insurance
Secretary, Western Zone
840 Helena Avenue
Helena, MT 59601

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance 5000 Building
5000 Capital Blvd.
Olympia, WA 98504-0255

Dear Commissioners:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an association examination was made of the corporate affairs and financial records of

STATES WEST LIFE INSURANCE COMPANY
of
Mountlake Terrace, Washington

hereinafter referred to as "SWLIC" or the "Company" at its home office located at 7001 220th Street SW, Mountlake Terrace, Washington 98043. The following report of examination is respectfully submitted showing the condition of the Company as of December 31, 2002.

SCOPE OF EXAMINATION

This examination covers the period January 1, 1998 through December 31, 2002 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administrative Code (WAC), Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination. The findings of the previous examination report were reviewed and any items that were not satisfactorily addressed by the Company are discussed later in this report.

Corporate records, along with external reference materials, and various aspects of the Company's operating procedures and financial records, were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTIONS

The examiners reviewed the Company's filed 2002 Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the annual statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC's Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exceptions noted while performing this review.

1. Revision of Capital and Surplus

In 1999, the state of California directed the Company to increase its paid-in capital to \$2,500,000. In 1999, the Company amended its Articles of Incorporation, stating in a cover letter to the OIC that "the amendment simply re-characterizes the paid-in capital and surplus capital amounts collectively as paid-in capital". However, the revised 1999 Articles of Incorporation actually increased the authorized common shares from 120,000 to 125,000 and doubled the per-share par value to \$20. SWLIC then reported in Item #17 of its annual statement, General Interrogatories, that it had 125,000 common shares issued and outstanding at \$20 par value per-share even though the Articles had only increased the authorized shares, leaving the issued shares unchanged at 120,000. The resulting \$2,500,000 in par value was shown in the annual statement, balance sheet, and the general ledger. Therefore, there are two errors. First, the 1999 notification to the OIC

was misleading. Second, the outstanding shares and the total par value were incorrectly reported as 125,000 shares and \$2,500,000 rather than 120,000 shares and \$2,400,000, respectively.

RCW 48.08.010(1) requires that an increase of capital stock should be made by an amendment to the Articles of Incorporation. This procedure was not properly followed to accomplish the issuance of 5,000 additional shares and to increase the total outstanding value of capital stock to \$2,500,000. Additionally, the original notification letter to the OIC was ambiguous in describing the contemplated change as simply a “re-characterization” of capital accounts.

The correctly revised Articles of Incorporation must be appropriately described and filed with the OIC in accordance with RCW 48.08.010(1). In addition, RCW 48.05.250 requires annual filing of a true statement of its financial condition in the annual statement form. The Company failed to correctly report its 120,000 outstanding capital stock shares and \$2,400,000 valuation during the period 1999 through 2002. Therefore, SWLIC is instructed to correctly report the information in all future annual statements and to file corrected Articles of Incorporation with the OIC.

2. Tax Allocation

The Company has utilized portions of its ultimate Parent’s (Premera Blue Cross) Net Operating Loss (NOL) Carry Forward and has not reimbursed the Parent for it. Accordingly, the Federal Income Taxes on the Summary of Operations is not properly charged on a separate return calculation basis as is claimed in the annual statement, Notes to Financial Statements. This results in inflated net income and unassigned funds (surplus) accounts. Since this practice began in 1988, the total of such NOL utilized by the Company has amounted to about \$19 million. This distorts the presentation of SWLIC’s financial position and operating results because SWLIC is utilizing its Parent’s NOL without accounting for the \$2,509,958 income tax reduction (computed at a 20% consolidated tax rate, less amount charged to SWLIC) which resulted from the utilization. SSAP No. 25, paragraph 14a, requires that a transaction conducted between affiliates for a bonafide business purpose “...shall be recorded at its fair value at the date of the transaction”. Accordingly, the benefit obtained by the Company must be recorded as an income tax expense and a liability to the Parent. (See examination adjustment A2.)

Pursuant to RCW 48.05.250, which requires the Company to “...file a true statement of its financial condition...”, and WAC 285-07-050(2) and RCW 48.05.073, which requires adherence to the NAIC Accounting Practices and Procedures Manuals (AP&P), the Company is instructed to make any appropriate accounting entries to correctly reflect the financial position of SWLIC, by booking the accumulated tax benefit as a reduction of earned surplus and a liability to the Parent.

3. Custodial Agreement

In the 2002 Annual Statement, Interrogatory #22.01, the Company stated that its Custodial Agreement with BNY Western Trust Company complied with the FCEH. However, the Custodial Agreement requires neither notification to the Insurance Commissioner nor maintenance of adequate insurance protection, both being required by the FCEH. In addition, the Custodial Agreement was not authorized by the Board of Directors as required by the FCEH, Part 1, General, Section J, Paragraph 1.

The Company is instructed to follow the AP&P instructions as required by WAC 284-07-050(2) and RCW 48.05.073. This includes the 2002 FCEH provisions requiring:

- **The custodian notify the commissioner if a custodial agreement is terminated or if all of the custodial account assets have been withdrawn (2002 FCEH, Part 1 - General, IV, Section H, Paragraph 2.f.).**
- **Maintenance of adequate insurance protection for its custodial assets (FCEH, Part 1 - General, IV, Section H, Paragraph 2.k.).**
- **The custodial agreement be authorized by the Board of Directors.**

4. Accounts and Records

Records supporting the calculation of bond premium and discount and prepayment assumptions for loan-backed securities were not provided. Without such records, the amortization of premiums and discounts for the loan-backed bonds listed in Schedule D - Part 1, could not be precisely validated.

The Company is instructed to maintain amortization schedules for individual investments that will tie to the amortization reported in its Schedule D and is instructed to comply with RCW 48.12.170(1)(b), which requires that bonds or evidences of debt having a fixed term and rate, "... if purchased above or below par ..." shall be valued "...on the basis of the purchase price adjusted so as to bring the value to par at the earliest date callable at par or maturing at par..." "...or in lieu of such method, according to such accepted method of valuation as is approved by the commissioner."

5. Service Agreements

The Company has not implemented written service agreements with affiliates, NorthStar Administrators, Inc., and Quality Solutions, as required by RCW 48.31B.030(1)(b)(iv) for all intercompany cost-sharing agreements. Such agreements are needed to cover costs associated with processing dental claims and auditing stop loss claims, which the Company currently handles through the general intercompany service agreement. This is

inadequate for these specialized services which should not be treated as general overhead costs.

Pursuant to RCW 48.31B.030(1)(b)(iv), management agreements, service agreements, and cost-sharing arrangements between the Company and its holding company system require written pre-notification to the commissioner before implementation. Therefore, the Company is instructed to submit to the OIC written service agreements with NorthStar Administrators, Inc., and Quality Solutions.

6. Conflict of Interest

Relevant conflict of interest declarations by the Company officers and various employees were reviewed. The Premera Code of Conduct requires all employees to disclose any potential conflicts of interest. However, two officers in 1997 did not complete a conflict of interest declaration. RCW 48.05.370 states, "Officers and directors of an insurer... shall be deemed to stand in a fiduciary relation to the insurer, and shall discharge the duties of their respective positions in good faith, and with that diligence, care and skill which ordinary prudent men would exercise under similar circumstances in like positions."

Pursuant to RCW 48.05.370, the Company is instructed to annually obtain and review conflict of interest declarations from appropriate personnel and to report the results to the Board, as required by its Conflict of Interest Policy.

7. Annual Statement Preparation

Pursuant to RCW 48.05.073, every insurer shall file its financial statements in accordance with the AP&P. In preparing its annual statements, SWLIC did not follow the AP&P in the following areas:

- **Policy loans** – reported as miscellaneous receivables, page 2, line 2401, which should have been reported on page 2, line 5.
- **Surrenders** – netted against premium income, page 4, line 1, which should have been reported on page 4, line 15.
- **Reinsurance payable on deferred and uncollected premiums** – netted against direct premiums on exhibit 1, part 1, and line 13.1, which should have been reported on exhibit 1, part 1, and line 13.2.
- **Remittances and items not allocated** – included as part of advance premiums, page 3, line 8, which should have been reported on page 3, line 19.
- **Notes to Financial Statements** - Note 12A, paragraphs 10-14, regarding Defined Benefit Plans and Note 12E, regarding Post Employment Benefits and Compensated Absences, were omitted from the 2002 Annual Statement. In Note 12A, paragraph 3 and Note 12B, the descriptions of the plans refer to them as belonging to the "Company". The plan descriptions should identify the correct

sponsor (Premera). Also, Note 12D is incomplete because it does not indicate whether the employer has any legal obligation for benefit under the plan.

- **Schedule D** – The Company does not maintain individual records to support a provisionally exempt rating of certain securities as required by the Purposes and Procedures Manual of the NAIC Securities Valuation Office, Part 4, (SVO Administrative Procedures) which states that for each provisionally exempt security, the insurer must maintain a record supporting its decision, including details of the terms of the security, documents verifying the security's rating, and documents evidencing the continued monitoring of the position.
- **Stop Loss Claim** – A stop loss claim of \$770,798 was omitted from the 2002 Annual Statement. (See examination adjustment A1.)

The Company also does not capture cash basis financial data on a separate basis. This led to a misstatement of paid claims and paid premiums. These misstatements were immaterial.

Pursuant to RCW 48.05.073, which requires conformity with the AP&P, and RCW 48.05.250, which requires a “true statement” in accordance with NAIC guidelines, the Company is instructed to follow the NAIC Annual Statement Instructions when preparing its annual statement and to reconcile its direct premiums and paid claims as part of its annual statement process.

8. Jurat Page

In 1997 and 1998, an individual was listed as an officer of SWLIC on the jurat page. This individual was not an officer but a consultant with the Company's actuarial consulting firm.

The Company is instructed to follow RCW 48.05.250 and annually present a true statement in the form approved by the NAIC. Since this individual was not an officer, he should not have been reported as such on the jurat page.

9. Appointed Actuary

The Company violated WAC 284-07-350(2) which states that a “Qualified actuary means an individual ...”. The Company appointed the actuarial consulting firm of Milliman and Robertson to provide actuarial service, but the actuary must be an individual person.

In accordance with WAC 284-07-350(3), the Board of Directors of SWLIC is instructed to properly appoint a qualified individual actuary and to give the commissioner the required written notice of that appointment.

COMMENTS AND RECOMMENDATIONS

1. Investment Management Agreement

The Company's Investment Management Agreement with Baird Advisors is neither dated nor signed by an authorized individual. The validity of any agreement is compromised when it is at variance with Company policy. Managers of SWLIC are authorized by the Company to execute contracts up to \$10,000. However, transactions under this contract are in excess of that limit and the signer is a manager, not an officer.

It is recommended that the Company ensure that its Investment Management Agreement with Baird Advisors is properly dated and signed by an authorized individual.

2. Check Signer

Since 1999, an unauthorized check signer, the underwriting manager, has been signing claim checks. As such, the Company has not maintained proper controls over its banking activities in accordance with its policies. A Board of Directors' resolution, effective April 28, 1997, provides a detailed description of those officials who are authorized to sign checks and their associated limits. The underwriting manager was not included in this description.

It is recommended that the Company comply with its policies by restricting check signing to only those persons who are authorized by the Board of Directors.

COMPANY PROFILE

Company History

The OIC's previous examination covered the period January 1, 1991 – December 31, 1997.

SWLIC is a Washington corporation organized in 1981 through a joint venture between Unigard Olympic Life Insurance Company (UOLIC) and Washington-Alaska Group Services, Inc. (WAGS).

WAGS is a for-profit Washington insurance agency wholly-owned by Premera Blue Cross (PBC). PBC is a Washington non-profit health care service contractor. Among other activities, WAGS provides life and disability insurance marketing services for the Company.

On December 1, 1983, UOLIC sold its 96,000 shares of common stock to WAGS for a base sale price of \$2.5 million plus adjustments. A new Board of Directors and officers were then elected and the Company's home office was moved to Seattle, Washington and later, to the current location in Mountlake Terrace, Washington.

In 1999, the Company amended its Articles of Incorporation (Articles), increasing its authorized shares from 120,000 to 125,000 and doubling the par value to \$20. However, as described in Instruction Number 1, its cover letter to the OIC erroneously described the change as a recharacterization of existing capital accounts, implying that there was no change to the total capitalization. SWLIC then showed the change in its Annual Statement as an increase in the outstanding shares to 125,000 at \$20 each, even though only the authorized shares were increased in the Articles, not the issued and outstanding shares.

Territory and Plan of Operation

SWLIC is licensed in several states and markets life and disability products primarily through a captive sales force of PBC.

In November 1981, the Company began business in Washington upon receiving a certificate of authority to transact life and disability insurance business. It was subsequently granted certificates of authority in the following states: Alaska (1981), Arizona (1986), California (1988), Oregon (1990), Idaho (1991), Montana (1991), North Dakota (1989), and Wyoming (1988). As of December 31, 2002, business had not been written in the states of Arizona, North Dakota, or Wyoming.

SWLIC writes the following group policies; life, accidental death and dismemberment, long-term disability, managed disability, short-term disability, and medical stop-loss. These product lines were developed to complement PBC's health care programs and to permit employers to buy total employee benefit packages from a single source. The Company is increasing its presence in Oregon, utilizing the sales force of its affiliated company, LifeWise Health Plan of Oregon, Inc.

The Company directly appoints and compensates agents and brokers to sell its products. It also pays compensation to PBC for distribution to PBC licensed sales representatives who sell SWLIC products and who are trained by SWLIC personnel.

Growth of Company

The Company's growth is illustrated below. All information is from the Company's filed annual statements.

	<u>Assets</u>	<u>Liabilities</u>	<u>Capital and Surplus</u>
1998	\$31,534,828	\$16,148,384	\$15,386,444
1999	37,495,170	17,943,266	19,551,904
2000	39,973,662	18,143,180	21,830,482
2001	45,915,254	19,315,235	26,600,019
2002	50,889,583	23,231,864	27,657,719

	<u>Premiums</u>	<u>Net Investment Income</u>	<u>Death Benefits</u>
1998	\$15,756,049	\$1,595,107	\$6,414,387
1999	16,105,419	1,813,352	4,401,139
2000	19,224,330	2,038,305	6,911,199
2001	24,822,044	2,219,136	7,381,122
2002	29,649,151	2,100,844	9,924,178

Business in Force by State

	<u>2002</u>
Alaska	\$1,514,498,294
California	6,551,500
Idaho	318,085,550
Montana	405,000
Oregon	158,373,586
Utah	15,459,500
Washington	4,694,327,156
Total	<u>\$6,707,700,586</u>

Affiliated Companies

PREMERA was organized in 1994 as the holding company for all of the PBC affiliates including the affiliation with Medical Service Corporation of Eastern Washington, MSC Service Corporation, and MSC Life Insurance Company.

Premera Blue Cross (PBC), 100% owned by PREMERA, is a non-profit Washington health care service contractor and the parent company of WAGS. The name was changed from Blue Cross of Washington & Alaska (BCWA) during 1998.

Washington-Alaska Group Services, Inc. (WAGS), a for-profit Washington insurance agency, is 100% owned by Premera Blue Cross and is the parent of SWLIC. WAGS markets various insurance carriers' individual health and disability policies and provides life and disability insurance marketing services to the Company. WAGS also acts as general agent for the Company's agency force. During 1994, WAGS became affiliated through a profit-sharing partnership with Pacific Health & Life of Oregon and its subsidiary, Western Benefit Administrators. Pacific Health & Life of Oregon changed its name during 1998 and became LifeWise, A Premera Health Plan, Inc., an affiliated company.

Intercompany Contracts

As of December 31, 2002, the Company was a party to the following intercompany contracts:

	<u>Effective Date</u>
Intercompany Service Agreement	January 10, 1994
Income Tax Allocation Agreement	May 29, 1997
Funding & Billing Services Agreement	July 1, 2002
Guaranty Agreement	March 3, 1994

MANAGEMENT AND CONTROL

Board of Directors

As of December 31, 2002, the Company is controlled by a five member Board of Directors (BOD).

<u>Name</u>	<u>Principal Business Affiliation</u>	<u>Member Since</u>
Murphy Jonathan Hensley	VP Sales – PBC	2002
Brian Eugene Ancell	EVP – PBC	2002
Herbert Randle Brereton Barlow	CEO – PBC	2002
Kent Steven Marquardt	EVP, CFO – PBC	1999
Stephen Dale Melton	President – SWLIC	1988

The Corporate Bylaws provide that the number of directors may be changed from time to time by amendment or by resolution of the BOD.

Officers

The officers as of December 31, 2002 were:

Stephen D. Melton	President and Chief Executive Officer
John Peter Domeika	Corporate Secretary
Sharilyn A. Campbell	Treasurer
Audrey L. Halvorson	Actuary

Committees

On April 27, 1992, the BOD created an Audit Committee, which consists of three members, none of whom are outside directors.

The BOD also has an active Investment Committee as well as a Finance Committee.

Conflict of Interest

The Conflict of Interest Policy requires periodic declarations by officers, directors, and key employees. At each BOD's meeting, all directors, officers, and key management personnel, as designated by the CEO or President and Chief Operating Officer, are required to disclose all relevant outside interests, memberships, associations, and affiliations. This information is reviewed by Company personnel and presented to the BOD if there is a potential conflict.

The Company also has a Code of Business Conduct and a Compliance Program which are reviewed and adopted each year by the BOD.

Fidelity Bond and Other Insurance

The Company is a named insured on a fidelity insurance policy purchased by PBC. Coverage limits to \$4,000,000 are provided for all of the insured affiliates. The minimum amount separately recommended by the NAIC for SWLIC is \$250,000 to \$300,000.

The Company is also a named insured on property and liability insurance obtained by PBC. On December 31, 2002, the policies provided coverages for real and personal property, commercial general liability, umbrella/excess liability, financial institution fidelity bond, fiduciary liability, directors' and officers' liability, errors and omissions liability, and managed care organization liability.

Officers', Employees', and Agents' Welfare and Pension Plans

Company employees are covered under the PBC benefit program. The program provides medical, dental, long-term disability, life, and optional personal accident coverage. The Company also offers eligible employees a (401K) program to which the Company contributes a percentage of the employees' contribution up to an annual limit.

The Company participates in a PREMERA-wide pension equity plan covering substantially all employees and in a PREMERA-wide post-retirement benefit plan, which provides certain healthcare benefits for eligible retired employees.

There is also a non-qualified defined benefit supplemental retirement program which covers executive management. Participants in this executive plan must have been employed by the Company for at least one year and hold a position which the PBC president and BOD approved as having a significant corporate-wide impact on the Company's strategic goals and objectives. The supplemental retirement program provides deferred income benefits to key management of PBC and the Company.

The executive incentive plan awards incentive pay to the president, executive vice president or higher-ranking officers of PBC or the President of a subsidiary. Awards are based on various performance goals.

Under the marketing division compensation plan, five or six Company employees annually received awards. The plan awards incentive pay based on new sales and profitability.

CORPORATE RECORDS

The Corporate By-Laws were amended on November 25, 2002. Section 3.2 of the By-Laws was amended to change the number of Directors to not less than 3 nor more than 15.

The meetings of the BOD and the shareholder are held semi-annually in April and October or November.

The BOD of WAGS elects the BOD of SWLIC.

MORTALITY AND LOSS

SWLIC provided copies of its actuarial workpapers and reserve reports as of December 31, 2002. Tests were performed on the underlying data, methods, and calculations as deemed necessary. Valuation reports and procedures were tested to establish that accurate and complete in-force information as of December 31, 2002, was represented in the valuation reports and workpapers. A sampling of contracts and payments was taken from active life and disabled life reserve reports, premium collection records, and paid claims reports. The samples were tested for completeness and accuracy and it was determined that the Company's calculations were based on accurate and complete data.

During the course of the examination, the OIC actuary performed such testing of the Company's reserving methodologies and philosophies as was deemed necessary to form an opinion with respect to the items reported. The actuary relied upon the Company's listings and summaries of in-force policies and contracts.

The general examination emphasis was to review the methods, assumptions, or other bases used to determine the reported annual statement items, and to determine whether the reported amounts were sufficient and in compliance with Washington law.

In the OIC actuary's opinion, the methods, assumptions, and methodologies used by the Company are generally appropriate, and most assets and liabilities on the annual statement were reported in accordance with accepted methods and principles.

REINSURANCE

A summary of the SWLIC reinsurance program as of December 31, 2002 follows:

<u>Coverage Type</u>	<u>Retention</u>	<u>Limits</u>
Group Life	\$250,000 incurred after 6/30/02 \$175,000 incurred after 1/1/97	\$2,000,000 \$2,000,000
Voluntary Life	\$100,000 incurred after 6/30/02 \$ 50,000 incurred after 6/30/97	Amounts in excess of \$300,000 subject to approval Amounts in excess of \$300,000 subject to approval
Group AD & D	\$50,000 incurred after 9/30/97 100% incurred prior to 10/1/97	\$5,000,000 inclusive Basic \$750,000; Voluntary \$250,000
Group LTD	50% Quota share	NONE
Voluntary LTD	50% Quota share	NONE
Catastrophic	\$600,000	\$5,000,000
Stop Loss (Assumed)	\$250,000 - \$500,000	\$1,000,000 or \$2,000,000 depending on plan
Stop Loss (Ceded)	Exceeds \$500,000	\$1,000,000 or \$2,000,000 depending on plan

The contracts have the required wording to minimize the Company risk. The Company does not do business with unauthorized reinsurers.

STATUTORY DEPOSITS

The Company has the following statutory deposits:

<u>State</u>	<u>Type</u>	<u>Par Value</u>	<u>Market Value</u>	<u>Statement Value</u>
New Mexico	US Treasury	\$200,000	\$207,813	\$204,463
Washington	US Treasury	\$1,500,000	\$1,558,589	\$1,533,472
Washington	Nations Treasury Funds	\$143,598	\$143,598	\$143,598

ACCOUNTING RECORDS AND PROCEDURES

The Company is a member of the PREMIER Holding Company Group and obtains its Information Systems (IS) support from PBC, the ultimate parent. The IS department has approximately 344 employees, including individuals assigned directly to individual subsidiary companies.

The accounting records, including the general ledger and subsidiary records, are maintained on a Generally Accepted Accounting Principal (GAAP) basis. Statutory statement balances are reconciled to the general ledger. Reconciling items consist of, but are not limited to, elimination of some deferred tax entries, fixed assets, prepaid assets, Financial Accounting Standards (FAS) 106 liabilities (changes in actuarial assumptions), and FAS 115 (accounting for certain debt and equity securities) and investment reporting differences.

SUBSEQUENT EVENTS

On August 25, 2003, the Company changed its name to LifeWise Assurance Company.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

All previous report instructions and comments were subsequently implemented.

FINANCIAL STATEMENTS

Assets, Liabilities, Surplus and Other Funds
Summary of Operations
Reconciliation of Surplus For the Period Since the Last Examination
Analysis of Changes in Financial Statements As a Result of the
Examination

**STATE WEST
LIFE INSURANCE COMPANY
ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS
DECEMBER 31, 2002**

	BALANCE PER COMPANY	REF	EXAM ADJ	BALANCE PER EXAM
<u>ASSETS</u>				
Bonds	\$42,150,823			\$42,150,823
Cash and short term investments	4,795,931			\$4,795,931
Reinsurance ceded: amounts recoverable	821,224			\$821,224
Subtotal, cash and invested assets	<u>47,767,978</u>		<u>\$0</u>	<u>47,767,978</u>
Life insurance premiums and annuity considerations, deferred and uncollected	546,511			\$546,511
Accident and health premiums due and unpaid	771,046			\$771,046
EDP equipment	\$2,155			\$2,155
Investment income due and accrued	518,925			\$518,925
Federal and foreign tax recoverable	682,347			\$682,347
Receivable from parent, subsidiaries and affiliates	599,621			\$599,621
Other assets	1,000			\$1,000
 TOTAL ASSETS	 <u>\$50,889,583</u>		 <u>\$0</u>	 <u>\$50,889,583</u>
<u>LIABILITIES</u>				
Aggregate reserve for life policies and contracts	\$4,946,323			\$4,946,323
Aggregate reserve for health	4,687,261			4,687,261
Policy and contract claims - life	2,208,393			2,208,393
Policy and contract claims - health (note #1)	4,598,723	A1	770,798	5,369,521
Premiums and annuity considerations received in advance	434,186			434,186
Provision for experience rating refunds	1,753,209			1,753,209
Interest Maintenance Reserve	456,454			456,454
Commissions to agents due and accrued	131,943			131,943
General expenses due or accrued	730,333			730,333
Taxes, licenses and fees due or accrued excluding fit	298,286			298,286
Amounts withheld or retained by company as agent or trustee	458			458
Asset valuation reserve	115,495			115,495
Payable to parent (note #2)	701,681	A2	2,509,958	3,211,639
Payable for securities	477,050			477,050
Aggregate write-ins for liabilities	<u>1,692,069</u>			<u>1,692,069</u>
TOTAL LIABILITIES	<u>\$23,231,864</u>		<u>\$3,280,756</u>	<u>\$26,512,620</u>
<u>SURPLUS AND OTHER FUNDS</u>				
Common capital stock	2,500,000			2,500,000
Gross paid in and contributed capital	0			\$0
Unassigned funds (surplus) (note #1 & #2)	<u>25,157,719</u>	A1 & 2	(3,280,756)	<u>\$21,876,963</u>
Capital and surplus	<u>27,657,719</u>		<u>(3,280,756)</u>	<u>24,376,963</u>
TOTAL LIABILITIES, SURPLUS AND OTHER FUNDS	<u>\$50,889,583</u>		<u>\$0</u>	<u>\$50,889,583</u>

**STATES WEST
LIFE INSURANCE COMPANY
SUMMARY OF OPERATIONS
December 31, 2002**

	BALANCE PER COMPANY	REF	EXAM ADJ	BALANCE PER EXAM
<u>INCOME</u>				
Premiums and annuity considerations	\$29,649,151			\$29,649,151
Net investment income	2,100,844			2,100,844
Amortization of Interest Maintenance Reserve	(56,102)			(56,102)
Aggregate write-ins for miscellaneous income	31,060			31,060
TOTAL	31,724,953		0	31,724,953
<u>BENEFITS</u>				
Death Benefits	9,924,178			9,924,178
Disability benefits and Benefits under accident and health policies (note #1)	10,906,396	A1	770,798	11,677,194
Increase in aggregate reserves for life and health policies and contracts	1,595,816			1,595,816
TOTAL - BENEFITS	22,426,390		770,798	23,197,188
<u>EXPENSES</u>				
Commissions on premiums and annuity considerations	1,748,126			1,748,126
General insurance expenses	4,468,444			4,468,444
Insurance taxes, licenses and fees, excl. federal income tax	1,011,757			1,011,757
Aggregate write-ins for expenses	753			753
TOTAL - BENEFITS and EXPENSES	29,655,470		770,798	30,426,268
Net gain from operations before dividends to policyholders and income taxes (note #1)	2,069,483	A1	(770,798)	1,298,685
Dividends	0			0
Federal income taxes incurred (excl. tax on capital gains) (note #2)	972,009	A2	186,198	1,158,207
Net gain from operations after dividends to policyholders and income taxes but before realized capital gains (losses) (note #1)	1,097,474	A1	(956,996)	140,478
Net realized capital gains or (losses) less capital gains tax	0		0	0
NET INCOME	\$1,097,474		(\$956,996)	\$140,478
Capital and Surplus, December 31, Previous Year	\$26,600,019		0	\$26,600,019
Net income (note #1)	1,097,474	A1	(956,996)	140,478
Change in net deferred income tax	25,640			25,640
Change in non-admitted assets and related items	(8,504)			(8,504)
Change in asset valuation reserve	(12,552)			(12,552)
Cumulative effect of changes in accounting principles (note #2)	(44,358)	A2	(2,323,760)	(2,368,118)
Net change in capital and surplus for the year (note #1 & #2)	1,057,700	A1	(3,280,756)	(2,223,056)
Capital and Surplus, December 31, 2002	\$27,657,719		(\$3,280,756)	\$24,376,963

**STATES WEST LIFE INSURANCE COMPANY
RECONCILIATION OF SURPLUS
FOR THE PERIOD SINCE THE LAST EXAMINATION**

	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
Capital and Surplus, December 31, Previous Year	\$26,600,019	\$21,830,482	\$19,551,904	\$15,386,444	\$14,124,755	\$12,026,722
Net income	1,097,474	3,650,933	2,147,803	3,729,222	1,595,086	1,981,204
Change in net unrealized capital gains (losses)		(75,654)	(814,692)	945,583	(751,268)	840,857
Change in net deferred income tax	25,640	141,934				
Change in reserve on acct of change in valuation basis			(199,773)			
Change in non-admitted assets and related item	(8,504)	(618,194)	629,113	(954,849)	(251,566)	169,908
Change in asset valuation reserve	(12,552)	907,191	467,214	(292,556)	669,437	(893,936)
Capital Changes – Paid In						
Cumulative effect of changes in accounting principles	(44,358)	763,327				
Change in surplus as a result of reinsurance			48,913	738,060		
Net change in capital and surplus for the year	<u>1,057,700</u>	<u>4,769,537</u>	<u>2,278,578</u>	<u>4,165,460</u>	<u>1,261,689</u>	<u>2,098,033</u>
Capital and surplus on December 31, 2002	<u>\$27,657,719</u>	<u>\$26,600,019</u>	<u>\$21,830,482</u>	<u>\$19,551,904</u>	<u>\$15,386,444</u>	<u>\$14,124,755</u>

STATES WEST LIFE INSURANCE COMPANY
Analysis of Changes in Financial Statements Resulting from the Examination
As of December 31, 2002

	<u>PER</u> <u>COMPANY</u>	<u>PER</u> <u>EXAMINATION</u>	<u>EXAMINATION</u> <u>ADJUSTMENT</u> <u>REFERENCE</u>	<u>INCREASE</u> <u>(DECREASE)</u> <u>IN SURPLUS</u>	<u>TOTALS</u>
Capital and Surplus, December 31, 2002 - Per Annual Statement					\$ 27,657,719
 <u>LIABILITIES</u>					
Accident and Health Claims	4,598,723	5,369,521	A1	(770,798)	
Payable to Parent	\$701,681	\$3,211,639	A2	(2,509,958)	
Change in surplus					<u>(3,280,756)</u>
Capital and Surplus, December 31, 2002 - Per Examination					\$ <u>24,376,963</u>

NOTES TO FINANCIAL STATEMENTS

The Company has no special consents, permitted practices, or orders from the state of Washington.

Note 1 A 2002 StopLoss Claim of \$770,798 was discovered and recorded by the Company in 2003. This is being recorded as an examination adjustment in 2002.

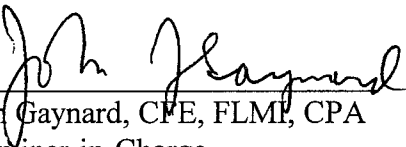
Note 2 The effect on SWLIC's surplus for use of the parent's Net Operating Loss for the years 1987 – 2002 without payment to the parent. \$2,323,760 was the effect on prior year's surplus while \$186,198 was the effect on 2002 surplus.

ACKNOWLEDGEMENT

The cooperation and assistance of the officers and employees of the Company during the examination are hereby acknowledged.

In addition to the undersigned, Susan J. Campbell, CPA, FLMI, Kathy Hicks, CPA; Keith Henderson, AFE, CFE; Orlando Gabriel, AFE; Alexis S. Santos, FSA, MAAA and Michael V. Jordan, CPA, CFE, MHP, all from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,



John Gaynard, CFE, FLMI, CPA

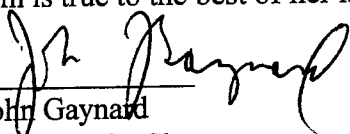
Examiner-in-Charge

Washington State Office of the Insurance Commissioner

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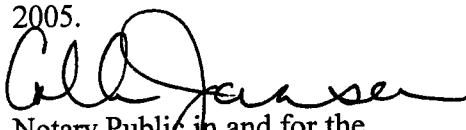
State of Washington)
) ss
County of King)

John Gaynard, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of her knowledge and belief.



John Gaynard
Examiner-in-Charge
State of Washington

Subscribed and sworn to before me on this 16th day of February,
2005.



Notary Public in and for the
State of Washington

